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IN THE

Supreme Court of the United States

OCTOBER TERM, 1972

No. 71-1059

KERN COUNTY LAND COMPANY,
Petitioner,

v.

OCCIDENTAL PETROLEUM CORPORATION,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR PETITIONER KERN COUNTY LAND COMPANY

DAVID R. HYDE,
Attorney for Petitioner
80 Pine Street
New York, New York 10005

Of Counsel:

CAHILL, GORDON, SONNETT, REINDEL & OHL
F. ARNOLD DAUM
WILLIAM E. HEGARTY
IMMANUEL KOHN
80 Pine Street
New York, New York 10005

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Petitioner respectfully submits this brief in reply to the answering brief of respondent Occidental Petroleum Corporation.

Occidental's "Counterstatement of the Case"

Occidental's 16-page "Counterstatement of the Case" confirms petitioner's showing that the decision below rests upon an *ad hoc* approach to Section 16(b) which would make Section 16(b) liability turn upon the particular facts of the particular case. Thus, Occidental enters into a detailed recital of its version of the facts in an apparent

effort to convince this Court of its lack of speculative purpose or intent, or access to inside information.

Since petitioner believes that it is the *kind of transaction*, objectively defined, which determines Section 16(b) liability rather than the particular facts of the particular case, including facts relating to such issues as the insider's intent and actual access to insider information, we make no effort to refute Occidental's self-serving statement item by item but simply note that it is one litigant's pre-trial version (there having been no trial below) of what occurred.*

In contrast to the detailed facts, the *kinds of transactions* involved here are undisputed. Occidental's purchase of Old Kern common stock, the Tenneco-Occidental option agreement and the exchange of Old Kern stock for Tenneco

* For example, while Occidental's brief denies that it had access to any inside information and treats as *de minimus* its five-man inspection of Old Kern's records (Br., pp. 10-11), the affidavit of Old Kern's Chairman demonstrates that prior to entering into the Option Agreement, Occidental's lawyers and accountants in fact inspected such non-public documents as Old Kern's general ledger, consolidating financial statements, consolidating journal entries, details of cash receipts from oil operations, supporting trial balances and other records over a six-day period (286a).

Similarly, while Occidental's brief denies that it ever threatened Tenneco with a proxy fight (pp. 11-12), the fact is that as late as May 31, 1967, in the midst of the negotiations with respect to the Option Agreement, Occidental filed a petition, sworn to by an Occidental officer, in the California Superior Court, stating that it had not decided whether or not "to oppose" the Tenneco-Old Kern transaction, and citing the time needed "to prepare proxy soliciting material" and "to file preliminary copies of such proxy soliciting material with the Securities and Exchange Commission" (474a-477a). Thus, despite Occidental's present denials, it is clear that Occidental used the leverage inherent in its 20% stock ownership position to help obtain for itself special treatment in the form of the Option Agreement.

Although we do not believe such facts as the foregoing are necessary to impose Section 16(b) liability upon Occidental, they do point up the abuses that may result from the kinds of short-swing transactions presented here.

Preference Stock are reflected in unambiguous written documents not susceptible to dispute. Petitioner respectfully submits that the only issues here are whether those *kinds of transactions* give rise to Section 16(b) liability.

The Occidental Option

In its argument concerning the June 2, 1967 option agreement, Occidental attempts at great length to demonstrate that an option is different from a conventional sale. However, as the Court of Appeals for the Seventh Circuit held in *Bershad* v. *McDonough*, 428 F.2d 693 (7th Cir. 1970), *cert. denied*, 400 U. S. 992 (1971), "[t]he phrase 'any purchase and sale' in Section 16(b) is . . . not to be limited or defined solely in terms of commercial law of sales and notions of contractual rights and duties" (428 F.2d at 697).

The *Bershad* decision holds that an insider's sale of an option is a "sale" under Section 16(b), noting that "[t]he insider's sale of options in his stock is well adapted to speculation and abuse of inside information, whether or not the option is subsequently exercised" and that "[s]ale of such purchase rights provides an easy vehicle for the use of inside information in extracting profits from the stock itself" (428 F.2d at 698).

Occidental's answering brief completely fails to meet the point made by the Seventh Circuit in the *Bershad* opinion concerning the speculative possibilities inherent in an insider's sale of an option, *qua* option. Instead, while conceding that an insider's short-swing sale of an option *may* fall within Section 16(b), Occidental would have the courts, in effect, attempt to distinguish "good" options from "bad" options and make each option case turn upon its distinctive facts.

Thus, Occidental attempts to demonstrate that the option in *Bershad* was a "bad" option because the premium was 14% of the purchase price (here it was just under 10%); the exercise price was allegedly 15% under market (here it was nearly 10% below Occidental's contemporaneous evaluation)*; and "incidents of stock ownership" were transferred (Occidental now concedes that simultaneously with the option it too conveyed a proxy to Tenneco; it also abandoned its pending demand for seats on Old Kern's Board).** The question of where the courts are supposed to draw the line between the "good" option and the "bad" option is carefully avoided.

In contrast to the *Bershad* option, Occidental attempts to demonstrate that its option was a "good" option. Indeed, as described by Occidental in its brief, its option was so fraught with risks and uncertainties that one wonders why Occidental would ever have, as it now admits (Br., p. 11), sought out Tenneco and proposed such a transaction. This gloomy appraisal is in sharp contrast to the contemporaneous appraisal given to Fortune Magazine by Occidental's President, Armand Hammer, shortly after the Option Agreement was entered into. At that time, Dr. Hammer, expressing no uncertainties as to whether or not the option

* As demonstrated in petitioner's main brief, Occidental's investment bankers appraised the Tenneco Preference Stock at $105 per share, which figure Occidental gave to its stockholders in its quarterly report, dated May 19, 1967. Thus, the $95 per share needed to exercise the June 2, 1967 Option Agreement (the $10 premium being credited against the option price) was nearly 10% below the value Occidental had just publicly assigned to the Tenneco shares. As in *Bershad*, exercise of the option was a virtual certainty.

** One contrast with *Bershad* Occidental totally ignores is the magnitude of the transaction. Here the non-refundable option price was nearly $9 million and concerned a $93 million block of stock. Trying to evaluate such an option in terms of the everyday put and call market is to ignore reality. For Tenneco or its assignee to forfeit the $9 million cash-in-hand paid to Occidental (while legally possible) was unlikely in the extreme.

would be exercised or whether a loss to Occidental could possibly result, boasted of looking forward to a profit of over $17 million, which he aptly observed "isn't bad for two weeks' work". Clearly, in Dr. Hammer's mind, the option was a sale.

Given the statutory definition of "sale" set forth in Section 3(a)(14) of the Securities Exchange Act, which the opinion below recognized includes the Occidental option (13A), Occidental's plea for a judicial exemption from the Act must, we respectfully submit, be denied. The Occidental option was an entirely voluntary transaction on its part. Admittedly, within days of becoming a statutory insider of Old Kern, Occidental sought out Tenneco, asked Tenneco's chairman "if he was interested in acquiring Occidental's Kern stock" (Occidental Br., p. 11), and turned to an option only because it hoped to avoid the impact of Section 16(b).

But, unlike the insider who waits the statutory six-month period before entering into a securities transaction, thereby avoiding 16(b), Occidental made its investment decision to enter into the Option Agreement on June 2, 1967, within one month of its purchase of 20% of Old Kern, based upon facts and conditions then available and known to it, and giving its proxy to vote the stock in question. It thereby immediately realized about $9 million cash-in-hand, in a transaction that ultimately netted it an $18 million profit, instead of the much lesser profit it would have made had it not sold its shares until six months had passed (see Petitioner's Main Br., p. 19). Occidental would have its cake and eat it too—enjoying the benefits of a short-swing transaction, without paying the price that Section 16(b) mandates.

The Occidental Exchange

In its discussion of the August 30, 1967 exchange of Old Kern shares for shares of Tenneco Preference Stock, Occidental would have this Court carve from Section 16(b) a special exemptory rule for beneficial owners of more than 10% of a class of equity securities, provided they have acquired such securities by means of a tender offer. This, of course, is exactly the relief Occidental unsuccessfully sought from the Securities and Exchange Commission in the summer of 1967. Indeed, Occidental's brief to this Court sets forth the very same arguments it then urged upon the Commission (202a-238a).

In urging that tender offerors should be accorded special treatment under Section 16(b), Occidental assumes that acquisition of securities in a tender offer followed by their short-swing disposition in a merger with another company presents little likelihood of speculative abuse. Such contention, however, like Occidental's proposed differentiation of "good" options from "bad" options, would require the courts to make an *ad hoc* disposition of each tender offer case arising under Section 16(b). Here, too, the courts would be called upon, in effect, to distinguish between "good" tender offerors and "bad" tender offerors, *i.e.*, those guilty of speculative abuse.

For the reasons set forth in petitioner's main brief, we respectfully submit that no such *ad hoc* treatment of tender offerors is indicated. Not only would it be contrary to all prior authority, but it would also undermine the "mechanical quality" of the statute, a feature stressed by this Court in its recent opinion in *Reliance Electric Co.* v. *Emerson Electric Co.*, 404 U. S. 418 (1972).

Occidental's brief to the contrary, there is absolutely no reason to assume that "unrestricted operation of the section",* will discourage *bona fide* tender offers. A Section

* *Cf.*, letter dated November 24, 1965 from the Securities and Exchange Commission to the Special Committee on Securities Regulation of the Association of the Bar of the City of New York, quoted in petitioner's main brief at pages 31-32.

16(b) recovery does not impose any penalty whatever on the unsuccessful tender offeror, leaving him with the full amount of his original investment. The notion that, in addition, he needs to be rewarded with the short-swing profits of his unsuccessful efforts is completely unfounded.

Nor is there any reason to assume that the tender offer situation presents no possibility for speculative abuse. See Note, 72 Colum. L. Rev. 1090, 1098 *et seq.* (1972). Here, Occidental itself was able to use its better than 20% position in Old Kern to obtain for itself under the Option Agreement a profit not enjoyed by the other shareholders.

Consequently, petitioner respectfully submits that, separate and apart from the question of whether the option itself constituted a "sale" for purposes of Section 16(b), Occidental's subsequent exchange of its shares of Old Kern must be deemed such a "sale".

CONCLUSION

For the reasons set forth above and in petitioner's main brief, the judgment of the Court of Appeals for the Second Circuit should be reversed.

Respectfully submitted,

David R. Hyde,
Attorney for Petitioner
80 Pine Street
New York, New York 10005

Of Counsel:

Cahill, Gordon, Sonnett, Reindel & Ohl
F. Arnold Daum
William E. Hegarty
Immanuel Kohn
80 Pine Street
New York, New York 10005